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The Car Business: Now that the rescue/bail out of the big 3 automakers has been completed by President Bush, the Fed and the Treasury Department (with the support of President-Elect Obama), I would like to give you all some of my views on what has been said and is still being said, about this industry, it's problems and it's prospects. Because of my 25 years experience in this industry, I know a few things that many of those talking heads on TV don't. It drives me crazy when someone pontificates with such surety about what went wrong and what is needed to go right, while their only experience with the car business is that they bought a car once. Please find my observations and comments below.

First, the Myths:

Myth #1: Domestic automakers are in trouble because they build poor quality cars - They used to. But so did the Japanese manufacturers in the 60s. But now quality in the car business is a price of admission and there is near quality parity among all manufacturers selling cars in the US market. While JD Power always ranks a first place and a last place, the difference between that first and last is much less than it used to be and in most cases the difference between 60 defects per 100 cars and 100 defects per 100 cars is imperceptible to the consumer. Oh sure, you may have a horror story about some car you had, but you are every bit as likely to have had that horror story with a Honda as you are with a Chevrolet. And occasionally some manufacturer has a bad patch of quality due to a new plant, or new model, or labor problems. (Volkswagen and Mercedes each had such patches recently) The fact is that a Hyundai, a Toyota and a Ford are all pretty damn good quality cars these days. The fact of the matter is that domestic car manufacturers build that are as good or better than many Asian and European cars.

Myth #2: Domestic automakers are failing because they don't build cars anyone wants to buy - If GM doesn't build cars anyone wants to buy, then why are they first in sales in North America? Why are they also first in the fast growing markets of China and Russia? GM and Ford are 1st, 2nd, or 3rd in sales in almost every market worldwide except Japan. They actually have a lot of sales success worldwide. Their problem is not that they don't sell enough cars. The true problem is that their cost structure is geared to selling even more cars than they have actually sold.

Myth #3: Domestic automakers have problems because they build too many big trucks and SUVs and not enough hybrids - In fact, almost the reverse is true. No manufacturer anywhere in the world is making a dime on any hybrids. They are all money losers. Toyota sells a lot of Prius's but loses money on every single one. Where does Toyota make their money in North America? With the Tundra (full-sized truck) and Sequoia (Full-sized SUV) and big Lexus's, etc. Toyota makes the same money on one Sequoia as they do on 4 Corollas. Hybrids are expensive because they require 2 redundant power trains (electric and gas), expensive batteries, and a complicated control mechanism. The consumer will not pay for all that cost. So, they are sold at a loss because all manufacturers want to seem to be "environmentally friendly". But, Toyota couldn't afford to lose that money on Prius if enough people don't buy trucks, SUVs and luxury cars. That's why Toyota just indefinitely postponed their planned Prius plant in the US. The reason for all of this is not rocket science. People perceive that bigger cars have more value. After all, they have more room, more power, more gadgets, etc. But the incremental cost of building a bigger car is less than the consumer's perception of the value. That's why bigger cars are more profitable. Every manufacturer works that way. BMW has a 1, 3, 5, and 7 series and the bigger is always more expensive, and more profitable. MiniCooper (a subsidiary of BMW) seems to have worked out a strategy for consumer acceptance of an expensive small car. But, it will take time for consumers to change such a fundamental perception across the broader market.

Myth #4: GM can just declare Chapter 11 bankruptcy and they will stay in business and be able to work things out - No. Not in this environment. A company that declares Chapter 11 reorganization must be able to secure "debtor in possession" financing to continue operations while they reorganize. Such financing is not available in today's credit markets at the volume necessary for a company the size of GM. Furthermore, car manufacturing today is highly complex and interconnected. For example, the launch of the very important new Chevy Camaro (a very cool car by the way), has been delayed several months because of problems with just one supplier. So, supplier bankruptcies would complicate any potential reorganization. Additionally most domestic dealers are financed by the "captive" finance companies: GMAC, Ford Motor Credit and Chrysler Credit. Had GMAC gone under, roughly 70% of GM's dealers would be unable to obtain financing (because hardly any banks will finance the car business in the current credit markets) and would have had to shut down within weeks. The bottom line is that GM and Chrysler without the federal aid, would have quickly fallen into Chapter 7 liquidation and many if not most of their dealers would have followed in short order. This would have resulted in the loss of millions of jobs.

Myth #5: The UAW contract is the whole reason that GM, Ford and Chrysler can't make money and UAW workers are making too much money - The problem is not that current UAW workers make too much money. In fact, newly hired UAW workers in a number of job classifications will make less money at a Ford plant than their non-union equivalents at a US

Honda or Nissan plant. The problem is that back in the 1980s, Big 3 executives made deals with their unions to pay for all kinds of costs after retirement, and to continue paying workers that had been laid off. The executives thereby preserved their current earnings by not incurring large increases in wages, but left the next generation of executives holding the bag for these costs after the original execs had retired to Florida (by the way, local governments are doing the same thing with their public employee union workers right now). The problem is not that the people working on the line today are paid too much in current wages. With robots and just-in-time suppliers, assembly line labor only makes up about 10% of the cost of a car now anyway. The problem is that for every current assembly line worker getting paid, the Big 3 are paying 6 non-working former employees either nearly full wages for years after being laid off or are paying unsustainable retirement and health care benefits. The \$78/hour figure you hear spreads the legacy costs over the existing workforce. They do not make anywhere near that much money today. Also, The US is not the only country with generous union contracts. Look no farther than Germany. Your Mercedes, if assembled in Germany, is done by workers who have a maximum 30 hour work week and 6 weeks a year paid vacation. Similar rules exist in France, Sweden, Italy and other countries. So, the UAW "legacy costs" are a big problem and cannot be sustained. But you cannot lay the failure of these companies at the feet of the current UAW wages.

Myth #6: Only the American car companies are having problems - Car sales worldwide are running down about 40% from 2 years ago. In an industry like this with high fixed costs (big expensive plants) and low margins (remember how you wouldn't pay even \$100 over invoice cost for your last car?), no one can survive if this level of sales were to be maintained. As proof, notice that Toyota posted its first loss in its 70 year history in 2008. They have shut down ALL of their plants in Japan for part of January and have idled 3 plants in the US as well as canceling future product programs. Honda just cancelled 4 major new future product programs and will discontinue some current models and has shut down their Formula 1 racing team in order to save money. The President of Fiat (which also owns Maserati, Alfa Romeo and Ferrari) said that Fiat cannot survive alone and must merge or be acquired. Nissan/Renault is also in a very precarious condition. The Swedish government is likely to bail out Saab (owned by GM) and Volvo (owned by Ford) and the Japanese and German governments may provide bail-outs to some of their auto makers. In the car world, this is not a recession but a full-blown depression. You will have many Japanese and European car makers in bankruptcy if the current sales levels were to continue for another year or more and their governments do not provide assistance. Of all car purchases in the US, 89% are financed. And with financing as difficult as it is right now, it is no surprise that the entire industry is under stress. Yes, the American car companies were weaker coming into this. But no manufacturer is immune from failure if the current market conditions continue.

Myth #7: The Big 3 are all in the same condition - Not true. Ford has the most cash and has not yet taken any federal money, but they will by summer unless the market improves. They (Ford) have mortgaged a bunch of their assets which GM has not done, but they kept their

finance arm (Ford Motor Credit) which will help them in the future. They also have the most new product offerings coming out, if they maintain their new product schedule. They also have a relatively simple brand strategy and have strong worldwide market presence. GM has the biggest sales and lots of unmortgaged assets but they have lost GMAC which will now be an independent entity. They have the best international operations, particularly in emerging markets, but they also have the biggest bureaucracy to downsize. Chrysler is in the worst position. They have no international operations to speak of and fewer strong brands. It is hard to see how Chrysler survives this, even with government assistance, in its current form.

So, what is the problem with the Big 3? They have made some bad management decisions of course. But they have been chasing increased market share for decades as their market share has steadily declined. They have never been able to accept the idea that they could be smaller but more profitable companies and instead have always spent like they were bigger than they actually were. That is an oversimplification of course. But if you spend \$100 thinking you can sell \$120, but only sell \$80 and you keep doing it because you have access to the cash flow and that \$120 is right around the corner, you will eventually run out of money. And they have.

There is still lots on the road ahead (pun intended) for the automakers. This is just my perspective on where they, and we, are now.

So go out and buy a car or truck! More on that in a later report.

Until next time, I remain respectfully,

Congressman John Campbell

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